The Squirrel Cage of Debt*

By Lawrence Dennis, *The Saturday Review of Literature*, June 24, 1933

This article is written in the light of the data and discussion contained in an excellent study entitled "The Internal Debts of the United States," just published under the auspices of the Twentieth Century Fund Incorporated. The director of the Twentieth Century Fund, Evans Clark, has edited the contributions of an impressive list of competent experts. The book merits high praise for the accuracy, adequacy, and manner of presentation of the statistical facts about our internal debts.

The analysis and recommendations of the book, however, fail to meet the fundamental challenge issuing from the world's credit impasse and related events, such, for instance, as the tarring of an Iowa judge who would not agree to deny mortgage foreclosures or the abandonment by the United States of the gold standard. In this respect, the book recalls Professor Seligman's two-volume study on installment selling, financed by the General Motors Corporation during the late installment selling boom. That ponderous piece of scholarship devoted but two or three brief sentences to a hurried allusion to the most important problem connected with installment credit, namely, the interest cost to consumers. The book, naturally, was packed with other curious and erudite data about installment selling. But a recent article in the Harvard Business Review contained more in a few pages about the interest cost of installment selling than Professor

Seligman's 800 pages of research. The contributor of the article showed that interest charges on a large number of representative types of installment sales range from 14% to 67% per annum. The recommendations of the Twentieth Century Fund scholars with regard to debt problems are necessarily conditioned by the fact that most of them are college professors for whom interest on debts is a lifetime meal ticket.

A continuing series of crises in our debt problems, domestic and foreign, enumeration of which seems superfluous, furnishes dramatic and conclusive evidence that this is distinctly a debt or credit depression. Free traders complain that tariffs have impeded trade and technocrats assure us that the machine is too productive for our market. Yet, during the period 1915-1929, tariffs did not prevent international trade from breaking all previous records. Nor do tariff walls today keep American farmers from exchanging with hungry, unemployed American factory workers a surplus of food for manufactures, which are needed and could be, but are not being, produced. As for the over-productivity of the machine, suffice it to remark that during the boom years, at the peak of production, millions of human wants went unsatisfied and millions of Americans subsisted below a minimum standard for decent living. It is evident that, under our system, all we need to sell goods abroad over the highest tariff walls or at home against the greatest sales resistance is enough loans for consumption. But prosperity through loans for consumption must be temporary, for periods of debt cancellation must follow periods of debt making. And there's the rub.

Hindrances to trade such as tariffs or human errors and frailties are like hindrances to the enjoyment of good health. Creations of

new credit or debt are like the vitalizing forces poured into the human body by the ductless glands. While new loans are pouring fresh streams of purchasing power into the economic organism we do all sorts of extravagant things such as fighting big wars, settling new continents, and building new industries. In the doing of these things we prosper and raise our standard of living. When the credit source begins to dry up, our economic system slows down and our standard of living falls. According to the figures of the Twentieth Century Fund, long-term debt in the United States rose from $37 billion in 1914 to $72 billion in 1920 and to $134 billion in 1929. Short-term debt rose from $51 billion at the end of 1913 to $102 billion in 1921 and to $150 billion at the end of 1929. By the end of 1931 short-term debt had declined to $112 billion and to $103 billion by the end of 1932. It is clear that prosperity goes with an increase in debt and that hard times accompany a net reduction of debt.

The question of the hour in respect to loans or interest is not whether credit expansion stimulates, or credit contraction paralyzes trade. Those questions are settled. Nor, in my opinion, is the problem, as the authors of "The Internal Debts of the United States" seem to think, that of making a debt economy work better. The first question, as I see it, is whether an economic system which can only be stimulated by credit expansion, always inevitably to be followed by painful deflation, can and should be modified by the substitution of a more stable dynamo.

It comes as news to most people to learn that practically all important ethical teachers — Moses, Aristotle, Jesus, Mohammed, and Saint Thomas Aquinas, for instance — have denounced lending at interest as usury and as morally wrong. Modern capitalism may be said to have arisen with the

Protestant Reformation and the triumph of the money lenders over the prohibitions of interest by the Roman Catholic canonists. The canonists, be it noted, did not forbid private ownership of property or the receipt of land rent and business profits. What they forbade was interest, or unconditional contracts to pay a money rental, regardless of the use made of the loaned funds or of the subsequent capacity of the debtor to pay.

Wars, the current consumption of governmental administration, and the current consumption of individuals who desire homes and luxuries which they cannot pay for out of income are responsible for a large percentage of all outstanding interest-bearing debt. Interest on consumptive loans must be paid for out of the standard of living of the debtor. If along with the growth of pub1ic and personal debt, it so happens that public and private incomes are increased by such extraneous factors as the opening up of new continents or the acquisition of new foreign markets, then the burden of debt incurred for past consumption may not be felt by the interest payers. But it is not the debt that causes the increase in income, and factors like population growth or territorial settlement cannot be expected forever to operate as they did in the nineteenth century to lighten debt burdens. Thus, for [text missing] the debts of the late war neither [text missing] new foreign markets for our European debtors nor settled new land anywhere in the world.

Goods consumed do not normally create a piece of physical property to pay the interest charges. And, as for money loaned to create capital, like railways, factories, apartment houses, or office buildings, it may happen, as the canonists saw, that the income from such properties may be negative. No one can tell at the time

a loan is made whether the asset created will in the future produce its interest and amortization charges. This being true, it is, as the canonists argued, immoral to set up a legal obligation which the obligor may be unable to discharge. Debts are such obligations.

The interesting fact about the usury doctrines of older teachers, ignored by modern scholars living on the fruits of usury and writing about debt, is that the unworkability of an interest-debt economy is now being proved by events. It may take several Hitlers to hammer home to many academic minds the significance of these events. Money debts create the market problem on which modern capitalism is now foundering. Under feudalism, the serf had obligations to the lord of the manor, and the nobles had obligations to the prince. But the dues of feudal days were always payable in goods and services. The obligor did not have first to sell his goods or services in a competitive free market in order to obtain the money with which to discharge his debt and keep his home and job. Unlike modern capitalism, feudalism had the elements of durability and may yet return, if a better order of collectivism is not evolved.

Society under feudalism could be divided into two classes: those who received more than they rendered and those who rendered more than they received. Society under modern capitalism can, likewise, be divided into the interest payers and the interest receivers. Feudalism could work for 500 years and more because those on the receiving end had promptly to consume or to invest their full income in new castles, palaces, churches, or public works. Modern capitalism tends to break down because those on the receiving end neither consume nor create permanent property fast enough but seek to compound through

consumptive loans a part of their total income. Debts are created for consumption which cannot furnish the future interest payments. One cent compounded at 6% semi-annually since the year one would now be worth a sum of money equal to several times the weight of the globe in fine gold. Obligations to render services or deliver goods and rights to receive such dues make sense. Money obligations and money rights make nonsense and world depressions when multiplied by compound interest.

Evans Clark in his introductory chapter on the Nation's Total Internal Debts makes an artful but unsuccessful attempt to dispose of the debt difficulty by saying that "There is no debtor class any more than there is a creditor class in the United States. Most of us are both at the same time." Such a statement is nonsense. One is a creditor or a debtor according to one's net position on balance. A man who receives more in interest on invested capital than he pays in interest on his private debts plus what he pays through taxes on the interest of the public debt is obviously a creditor. And a man who pays in interest more than he receives in interest is a debtor. It is absurd to say that a farmer who pays $1,000 a year in interest and receives $50 a year in interest on an insurance policy is as much a creditor as he is a debtor.

The fundamental difference between modern capitalism and medieval feudalism is that under the prevailing order, the debtors are called on to do the impossible. The American farmer and the European government in debt to the United States government have been asked to make money payments in dollars which were not obtainable from the sale of currently produced goods and services. The transfer problem is the same for the American farmer as for the British Government. Debts

must be paid in money which is not obtainable inadequate amount at present commodity prices. And present prices are an inevitable result of a prolonged period of debt reduction. And a prolonged period of debt reduction must inevitably follow a prolonged period of debt increase. And a prolonged period of debt increase is the only way under a debt economy to enjoy prosperity. All roads to recovery now indicate the need for making additional loans or credit expansion.

The significance of our abandonment of the gold standard is that debt cancellation, en masse, is periodically inevitable under a debt system and that Mr. Roosevelt prefers a repudiation of our government's gold clause obligation to the foreclosure of millions of farms and homes and the breaking of most of our banks. The White House tells us that it is absurd to maintain gold redemption when our gold debt is twenty times as much as our gold stock. But the White House should have pushed its logic further. Our long and short-term debt combined, according to the figures of the Twentieth Century Fund, aggregates some $237 billion. (There is, of course, much duplication in this total.) Our total currency issued or available for issue is less than $15 billions under present currency laws. Therefore, there are not enough paper dollars to pay debts. Therefore, the White House might have said, let us abolish debts as well as the gold clause obligation.

The inflationists propose to meet any difficulty of insufficient money by fiat creations of currency or deposits. But they forget that loan contracts are pointless if the purchasing power of the currency is not maintained. The champions of a managed currency believe that they can stabilize the purchasing power of the dollar better than the gold standard. Possibly they might do

as well with planned money as with the observance of a fixed ratio between a rare metal like gold and the outstanding volume of money, provided the currency managers could prevent the increase of debt. But how can an increase in the amount of debt be prevented if the money lenders as a whole do not want either to spend or invest all of their interest income outside of the field of loans?

Mr. Clark's symposium on the "Internal Debts of the United States" evades the fundamentals of the debt problem. The general recommendations state that there are two approaches to the debt problem. The first assumes our economy as given and seeks to solve the debt problem by adjustments on the side of debts. This means bigger and better mortgage foreclosures, bankruptcies, bank closures, and reorganization to bring debts down to present prices. The second approach accepts the debts as given and seeks to adjust the economy to their existence. This means lifting prices and production to a level corresponding to present debts. The recommendations of the book favor the second method and purpose: (1) measures of immediate relief, of a discriminatory nature, aiming to give assistance only where needed to avert credit losses through bankruptcy or foreclosure (the academic experts are plainly concerned most about the incomes of the interest receivers); (2) inflationary measures to induce recovery by enlarging the underlying base of credit and increasing its use, public expenditures on works to be used generously for the initial stimulation.

The advantages of debt are stated and defended as being those of (1) greater relative safety in a debtor's promise than in an owner's proprietary interest in a piece of property (the lender is the absentee capitalist who seeks to avoid the risks of enterprise

and management, relinquishing certain dubious chances of larger return for greater security. He has the special sympathy of scholars whose stipends are paid largely out of interest.); (2) lack of such responsibility as attaches to the ownership of land or common stocks or a business requiring personal attention (irresponsible and absentee ownership a dear to the money-lender.); (3) greater liquidity or ease of conversion into cash than is found in other types of property. (Greater liquidity suits the speculative interests of Wall Street finance.)

The only serious disadvantages of debt perceived by the authors of this book are those that grow out of price instability. They assume that if the dollar does not fluctuate greatly in value, loans will be sufficiently productive and debtors sufficiently capable of bearing their interest burdens. The old argument that “debts are savings put to use” is advanced without the qualifying explanation that the use to which savings are put in the case of a large number of loans is war, consumptive expenditures, or unsuccessful business ventures. The fundamental problems of interest, therefore, are persistently ignored.

Taking the position that most of what is wrong with debt is price instability, the author of the general recommendations outlines as steps towards economic stability a series of measures for the control of money and for the creation of new capital. It is not recognized that stable, in practice, means static, and that static means the negation of progress or change. The basic problem of any stabilizing control of credit is that of allowing some people to lend and borrow while others are prevented from so doing. Control of credit must prevent expansion which is not in proper proportion with increasing production. Over-rapid expansion, of course, always takes place in boom periods. Let us suppose that

in 1929 a credit controller had decided that instead of the $10 billion of new securities which were marketed in that fateful year, $6 billion was the right quantity. How could he be justified the fairness or wisdom of his decisions in, (1) decreeing that the manipulator of one plot of land instead of the manipulators of two other plots of land should be allowed to obtain from willing lenders money with which to build?, (2) assigning money to one industry instead of another for expansion?, (3) allotting investment capital to one region or city instead of another? Control by the government instead of the play of a comparatively free market seems to me unthinkable where uses of money have to be selected for private profit instead of public welfare.

A debtless economy seems far more feasible than a system of government planning for six percent and safety. It is an easy matter for the state to refuse to enforce any unconditional contracts to make future payments in money. Capitalists can easily be made to assume all the risks of investment. States and individuals can be made to pay as they go and live within their incomes. The essence of the debt problem is the undertaking by the state to enforce impossible contracts. The state eventually renounces its undertaking through the processes of bankruptcy, repudiation of debts, or devaluation of the currency. The trouble is that final disposition of an impossible debt burden can never be reached under a debt enforcing system until the economic life of the people has been upset for a long period. Ethical teachers grasped this problem over 2,000 years ago. The scholarly pensioners of usury, however, still refuse to take cognizance of the real debt problem.

Lawrence Dennis, the author of “Is Capitalism Doomed?” and formerly of J. & W. Seligman & Co., spoke recently before a Senate Committee on “Spending Our Way Out of Depression.”

* The Internal Debts Of The United States. Edited by Evans Clark. New York: The Macmillan Co. 1933. $4.50.